



**The American Society of International Law  
Task Force on Terrorism**

**Effective Enforcement of International Obligations  
to Suppress the Financing of Terror**

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## **Effective Enforcement of International Obligations to Suppress the Financing of Terror**

**Mark Kantor\***

The war against financial support for terrorism will not be won inside the boundaries of the United States. To avoid ineffective international efforts, the United States should lead a financial coalition of money center countries to bring pressure on States failing to adequately implement the U.N. Security Council Resolutions imposing mandatory “terror financing” controls on all States, as well as the International Convention on the Suppression of the Financing of Terrorism (the “Convention”). National efforts to restrict terror financing since September 11, such as the USA Patriot Act, have been serious and far-reaching, and of course controversial in a number of respects. However, the USA Patriot Act does little to persuade other States to impose effective controls over terror financing, particularly those States with underdeveloped legal and financial systems. Moreover, neither the United Nations Security Council Resolutions nor the Convention contain practical tools to change the conduct of States which fail to implement their international obligations to suppress terror financing (“non-implementing States”). Unilateral U.S. actions to pressure recalcitrant States will be ineffective unless money center States join in the creation of incentives and collective imposition of penalties on non-implementing States.

Such pressures must be serious to be effective, and should include specific sanctions to financially isolate non-implementing States. Threats, of course, are insufficient by themselves. The financial coalition must also be prepared to provide financial and technical assistance to authorities in non-implementing States. Otherwise, those States will be unable to raise the level of their regulatory supervision of financial institutions, alternate money transfer enterprises and internal corporate controls to levels sufficient to implement the Security Council and Convention requirements.

Several practical circumstances conspire to limit the effectiveness of national efforts in the United States, Europe, Japan and elsewhere to tighten controls over terror financing. The first difficulty lies in the relatively small amounts of hard currency funding necessary to pursue a terrorist

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operation. Estimates of the cost of the September 11 attacks range from \$500,000 to \$600,000 in the aggregate,<sup>1</sup> including wire transfers through at least 24 bank accounts in four different banks.<sup>2</sup> Transfer amounts were deliberately kept small by use of multiple transfers. For example, four wires aggregating about \$110,000 were initiated during July, August and September 2000 from the United Arab Emirates to the various Florida accounts of one of the September 11 hijackers. Each individual transfer was in an amount that would not ordinarily raise a law enforcement red flag. Immediately prior to the September 11 attacks, several hijackers transferred unused funds back to recipients in the UAE through money service businesses in amounts ranging from \$2,860 to \$5,400; again, well below the thresholds that might trigger unwanted attention.<sup>3</sup> A financial profile of the hijackers prepared by the FBI for testimony in February 2002 before Congress is attached as an appendix to this Essay. As that profile demonstrates, the financial activities of the September 11 hijackers were designed to stay below the radar of banking officers and law enforcement agencies.

Pre-September 11 terrorist operations were even less expensive. Reports<sup>4</sup> have estimated the entire cost of the first World Trade Center bombing in 1993 at \$18,000, including plane tickets, equipment purchases, van rental, purchase of a car, and rental of a garage, two apartments and a self-storage space. Unpaid phone bills totaled another \$6,000. The suicide attacks on the U.S.S. Cole in Aden in 2000 and the U.S. Marine Barracks and U.S. Embassy in Lebanon in 1983-84 likely involved local currency outlays and cost far less than attacks in the West. Such relatively small amounts can easily slip through even an aggressive Western system of controls, particularly if broken into multiple transfers to multiple pockets for multiple recipients.

The sources and methods of funding terrorism networks have grown widely diversified. Among the sources are donations to charities, use of shell companies and otherwise legitimate

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<sup>1</sup> James Risen, Sept. 11 Hijackers Said to Fake Data on Bank Accounts, New York Times, July 10, 2002, A2, A17.

<sup>2</sup> Testimony of Mary Lee Warren, Deputy Assistant Attorney General, Criminal Division, U.S. Department of Justice, before the Subcommittee on Oversight and Investigations, Committee on Financial Services, U.S. House of Representatives, at 10-11 (February 12, 2002).

<sup>3</sup> *Id.*

<sup>4</sup> See, e.g., FAQ's about Osama bin Laden, Part II, Vol. 1, Issue 3, Business Controls, Inc.: Latest Security News Headlines, October 11, 2001 (available at [www.businesscontrols.com/newsletter/securitynews/volume1\\_issue3\\_10\\_11\\_2001.html](http://www.businesscontrols.com/newsletter/securitynews/volume1_issue3_10_11_2001.html)).



businesses, and narcotics trafficking.<sup>5</sup> Methods of moving money, in addition to wire transfers through commercial banks, include trade mispricing, credit and debit cards, informal value and underground banking systems and bulk cash smuggling.<sup>6</sup> The emergence of trust-based money transfer systems such as hawala for cross-border funds transfers creates even more enforcement difficulties, as those networks lie outside the regulatory system covering financial markets and clearing systems. The worldwide growth of bearer instruments in the capital and commodities markets also makes tracing the ownership of the value embodied in those instruments extremely difficult. In addition, the use of portable commodities such as diamonds and gold, rather than direct money transfers, requires that attention be paid to merchant markets outside the financial community.<sup>7</sup> Techniques such as over- or under-invoicing, which convert a legitimate sales transaction into a device for illicitly transferring value, compound the challenges.

“‘It was a paradigm shift in the financial organization that we missed,” said one European financial investigator. “Everyone was trying to find bank accounts in Geneva when al Qaeda was greatly reducing their exposure in the formal financial sector. Now we are finding tentacles into all kinds of precious stones and metals.”<sup>8</sup> In recognition of the shift towards informal methods of storing and moving terror funds, the U.S. and its allies have also shifted towards new enforcement targets and methods. Deputy Secretary of the Treasury Kenneth Dam recently described the change in focus. “[W]e are entering into a new phase of the war. This new phase will be dominated by greater leadership by our coalition partners and greater focus on means of financing terrorism outside of the mainstream financial system.”<sup>9</sup>

First steps in this new phase have already been taken. An international conference on hawala networks during May 2002 ended with agreement to take steps to regulate and monitor informal

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<sup>5</sup> Testimony of Juan C. Zarate, Deputy Assistant Secretary for Terrorism and Violent Crime, U.S. Department of the Treasury, before the Subcommittee on Oversight and Investigations, Committee on Financial Services, U.S. House of Representatives (February 12, 2002)(PO-1009)(available at <http://financialservices.house.gov/media/pdf/021202jz.pdf>).

<sup>6</sup> *Id.*

<sup>7</sup> Karen DeYoung & Douglas Farah, *Infighting Slows Hunt for Hidden Al Qaeda Assets*, *The Washington Post*, June 18, 2002, A1, A10.

<sup>8</sup> *Id.*, at A10.

<sup>9</sup> Kenneth W. Dam, Deputy Secretary of the Treasury, “The Financial Front of the War on Terrorism – The Next Phase,” speech before the Council on Foreign Relations, New



money remitters. Promptly thereafter, both the United Arab Emirates and India announced their intention to develop the necessary regulatory schemes. Other steps have undoubtedly been taken outside the glare of the media:

“Foreign governments have acted privately to stop individuals from donating money to suspect groups. Foreign governments have arrested terrorist financiers or, as in the case of Pakistan, cooperated in successful U.S. efforts to capture them. Foreign governments are taking steps to regulate hawala dealers.”<sup>10</sup>

Efforts to focus on improper invoicing of commercial sales have also been increased. When the U.S. Customs Service identified sales at abnormal prices by three Yemen-based honey businesses, that information helped trigger freezing of the assets of those enterprises as associates of Al Qaeda.<sup>11</sup>

However, any optimism that Western countries can develop a comprehensive system for tracking small amounts of money appears misplaced. New money transfer products and technologies threaten to outrace existing regulatory schemes. For example, how will regulators supervise the international telecommunications companies that are developing combination calling cards/money transfer cards for sale at millions of retail outlets like today’s phone cards? The amounts at issue are too small and the means of engaging in financial transactions too varied to engender confidence that effective methods of detection can be developed. While such a system will certainly achieve some successes and may have a deterrent impact, it will also encourage terrorists to use non-traditional vehicles to evade the net cast over more traditional financial institutions. Thus, the movement by Al Qaeda towards alternate means of transferring money is said to have begun in earnest after the United States froze \$254 million of Taliban funds in 1998 in response to the bombing of the U.S. embassies in East Africa.

In contrast to the costs of funding terror operations, the costs of developing terrorist infrastructure and making other “terrorist capital expenditures” by purchasing and transporting bulk goods and equipment and supplying mujahadein groups are substantially larger. “The number we use is

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York, New York, June 8, 2002 (PO-3163), available at [www.treas.gov/press/releases/po3163.htm](http://www.treas.gov/press/releases/po3163.htm).

<sup>10</sup> Id.

<sup>11</sup> Id.



\$100 million a year for al Qaeda's operations and support of the Taliban in Afghanistan and groups in Chechnya and Bosnia, but that really is a number pulled out of the air," according to one U.S. law enforcement official.<sup>12</sup>

Because planning and implementation of capital expenditures requires a period of time to execute, the money for these expenses can be expected to accumulate in accounts (or other stores of value) for a longer period of time than is the case for terrorist operations. Therefore, those larger aggregations should be easier to identify and track. However, several factors militate against easy identification of these activities as well. One important consequence of U.S. operations in Afghanistan has been to eliminate the large terrorist training camps in that country. U.S. actions in connection with Afghanistan have also disrupted Afghani-based support for Chechnyan and Bosnian jihadis. These positive developments have had an effect on the financial battle. The demand for larger money movements to support those activities has disappeared and thus the remaining money flows are smaller and more difficult to track. Further, terrorist capital expenditures are unlikely to be sited inside Western countries, in contrast to many actual terror operations. Some hard currency funds to pay for these expenditures may be transferred through money center correspondent bank accounts. However, it is unrealistic to expect accumulations in money center accounts. Instead, those accumulations will more often occur in non-implementing States. Accordingly, even strict enforcement of terror financing controls in money center jurisdictions is not enough. To be effective, non-implementing States must be persuaded to suppress terrorism financing as well.

Enforcement of the relevant Security Council Resolutions and the Convention by non-implementing States would greatly enhance the ability to control terror capital abroad. Acting under Chapter VII of the United Nations Charter, the U.N. Security Council passed a number of strong enactments promptly after the September 11 attacks focusing on the financial aspects of terrorism. Chapter VII, in Article 48(1), obligates Member States to comply with decisions of the United Nations Security Council.<sup>13</sup> The obligation to comply with Security Council directives is

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<sup>12</sup> Quoted in DeYoung & Farah, *supra* n.7, at A10.

<sup>13</sup> "The action required to carry out the decisions of the Security Council for the maintenance of international peace and security shall be taken by all the Members of the United Nations or by some of them, as the Security Council may determine." Charter of the United Nations, Article 48(1) (June 26, 1945).



reinforced in Article 25 of the Charter,<sup>14</sup> and Article 2(5) of the Charter obligates Member States to assist the United Nations with any action taken in accordance with the Charter.<sup>15</sup> The Security Council has repeatedly made clear that its resolutions regarding terror financing are binding on each State that is a member of the United Nations. On September 28, 2001, the first of these Resolutions was passed. Security Council Resolution No. 1373 provides, *inter alia*, that

“all States shall:

(a) Prevent and suppress the financing of terrorist acts;

(b) Criminalize the wilful provision or collection, by any means, directly or indirectly, of funds by their nationals or in their territories with the intention that the funds should be used, or in the knowledge that they are to be used, in order to carry out terrorist acts;

(c) Freeze without delay funds and other financial assets or economic resources of persons who commit, or attempt to commit, terrorist acts or participate in or facilitate the commission of terrorist acts; of entities owned or controlled directly or indirectly by such persons; and of persons and entities acting on behalf of, or at the direction of such persons and entities, including funds derived or generated from property owned or controlled directly or indirectly by such persons and associated persons and entities;

(d) Prohibit their nationals or any persons and entities within their territories from making any funds, financial assets or economic resources or financial or other related services available, directly or indirectly, for the benefit of persons who commit or attempt to commit or facilitate or participate in the commission of terrorist acts, of entities owned or controlled, directly or indirectly, by such persons

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<sup>14</sup> “The Members of the United Nations agree to accept and carry out the decisions of the Security Council in accordance with the present Charter.” Charter of the United Nations, Article 25 (June 26, 1945).

<sup>15</sup> “All Members shall give the United Nations every assistance in any action it takes in accordance with the present Charter, and shall refrain from giving assistance to any state against which the United Nations is taking preventive or enforcement action.” *Id.*, Art. 2(5).



and of persons and entities acting on behalf of or at the direction of such persons;...”

Moreover, Resolution No. 1373 obligates all States to “[d]eny safe haven to those who finance [or] support ... terrorist acts, or provide safe havens” and to “[e]nsure that any person who participates in the financing ... of terrorist acts or in supporting terrorist acts is brought to justice....” To implement these mandated obligations, the Resolution calls on all States to “[b]ecome parties as soon as possible to the relevant international conventions and protocols relating to terrorism, including the International Convention for the Suppression of the Financing of Terrorism of 9 December 1999....” The Security Council also established a Counter-Terrorism Committee under Resolution No. 1373 to supervise implementation of these and other requirements of the Resolution. As part of this effort, the Counter-Terrorism Committee was tasked with obtaining reports from all member States of the United Nations as to compliance with their obligations under the Resolution. The Counter-Terrorism Committee has not, however, been given any enforcement powers.

Subsequent Security Council Resolutions Nos. 1377 (12 November 2001) and 1390 (28 January 2002) underscored the international legal obligation of States to deny financial support and safe haven to terror supporters. In the case of Resolution No. 1390, the Security Council again acted under authority of Chapter VII of the Charter. That Resolution requires all States to freeze financial assets and economic resources of “Usama bin Laden, members of the Al-Qaida organization and the Taliban and other individuals, groups, undertakings and entities associated with them,” as named on a continually updated list. The Afghanistan Sanctions Committee set up under Resolution No. 1367 (15 October 1999) to monitor sanctions against the Taliban was charged under Resolution No. 1390 to obtain reports from each State as to compliance with the obligation to freeze Al Qaeda-related assets as well. Nothing in these Resolutions, however, addresses the consequences to a State of failing to fulfill its obligations; neither sticks nor carrots are specified.

At the national level, the USA Patriot Act reinforced on-going efforts by the U.S. Government to lead international cooperative efforts through the 29-member Financial Action Task Force on Money Laundering (the “FATF”), and cooperation among financial services regulators, customs authorities, tax authorities and law enforcement agencies across the world. Congress instructed the Executive Branch in the USA Patriot Act to undertake negotiations and cooperate with



regulatory authorities in other countries on a variety of issues related to terror financing, money laundering and other financial crimes.<sup>16</sup>

As Security Council Resolution No. 1373 recognized, the Convention is a fundamental part of the framework for controlling international terror financing. If effectively implemented, the Convention will prove to be a crucial tool. At the time of this Essay, over 130 States had signed the treaty, but only 40 had completed ratification (the great majority after September 11). Iran, Iraq, Syria, Pakistan or Yemen have not signed the Convention. Ratification has not yet occurred in Bahrain, Egypt, India, Indonesia, Israel, Jordan, Libya, Morocco, the Philippines, Russia, Saudi Arabia, Singapore, Somalia, Sudan, Thailand or Tunisia. The United States itself did not complete ratification until June 26, 2002. The credibility of adherence to the Convention by some ratifying States, including Cuba and the Democratic People's Republic of Korea, is also suspect. Becoming a party to the Convention is insufficient of itself unless that party adequately enforces the requirements of the Convention.

Several of the provisions of the Convention on the Financing of Terrorism deserve specific mention. Article 2.1 requires signatories to provide for the establishment of a criminal offense under national law if a person:

“by any means, directly or indirectly, unlawfully and willfully, provides or collects funds with the intention that they should be used, in full or in part, in order to carry out: (a) An act which constitutes an offense within the scope of and as defined in [any one of nine listed international instruments addressing specific terrorist conduct such as hostage taking, aircraft and maritime hijackings and bombings, and any other international instrument added to the list from time to time in the manner provided in the Convention]; or (b) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature and conduct, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act.”

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<sup>16</sup> See, e.g., Sections 328 (inclusion of the names of originators on wire transfers), 330 (maintenance of and access to financial records of foreign financial institutions) and 361 (Financial Crimes Enforcement Network).



Thus, the scope of terrorist activities covered by the Convention as predicate conduct to a financial offense is in fact quite broad. That breadth is surprising in light of the absence of international consensus as to the scope of the term “terrorist” (but may help to explain the limited number of ratifications). The term “funds” is also broadly defined in Article 1.1 of the Convention to cover assets of any kind. Article 2.3 emphasizes that it is not necessary that the funds be actually used to carry out the terrorist activity. Articles 2.4 and 2.5 further criminalize attempts to commit an offense, participation as an accomplice in an offense, organization or direction of others to commit an offense and certain intentional contributions to the commission of an offense by a group with a common purpose. It is important to note that the Convention criminalizes conduct beyond money laundering: “The difference between money laundering and the financing of terrorism is that moneys used to fund terrorist activities are not necessarily illegal. Assets and profits acquired by legitimate means and even declared to tax authorities can be used to finance terrorist acts, too.”<sup>17</sup> The Convention, therefore, criminalizes a wide range of activities intended to financially support terrorist activities, regardless of whether an act of terror was ultimately committed, regardless of whether the funds in question were acquired legally or illegally and regardless of whether the funds in question were actually used to finance terrorist acts.

In addition to requiring the criminalization of terror financing, the Convention obligates each signatory State under Article 8 to take appropriate measures, in accordance with its domestic legal principles, for the identification, detection, and freezing of funds used or allocated for the purpose of committing covered offenses and the forfeiture of such funds and the proceeds derived from covered offenses. It is here that a serious weakness of the Convention becomes apparent. The Convention does not specify the nature of those measures. Also, the Convention does not address what supervision, examination and accounting requirements are necessary to enable unlawful conduct to be identified or prevented. Indeed, like the Security Council Resolutions, the Convention does not go beyond criminal law and sanctions to translate these obligations into effective administrative measures. Nor does the Convention establish any body to monitor efforts by States to comply with its requirements, although the creation by the Security Council of the Counter-Terrorism Committee will do much to alleviate this failure.

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<sup>17</sup> Walter Gehr, Recurrent Issues (Briefing for member States on 4 April 2002), available at [www.un.org/Docs/sc/committees/1373/rc.htm](http://www.un.org/Docs/sc/committees/1373/rc.htm), at text following footnote 2.



The FAFT has stepped into the implementation gap by making some practical recommendations as to appropriate measures and offering technical assistance to interested States. In addition to exhorting States to adopt the Convention, criminalize terror financing and money laundering activities, and freeze and confiscate terrorist funds, the FAFT has also proposed the following steps as part of eight Special Recommendations<sup>18</sup> on terrorist financing made by the FAFT at the conclusion of a conference in Washington, D.C. on October 30, 2001:

***“ IV. Reporting suspicious transactions related to terrorism***

If financial institutions, or other businesses or entities subject to anti-money laundering obligations, suspect or have reasonable grounds to suspect that funds are linked or related to, or are to be used for terrorism, terrorist acts or by terrorist organisations, they should be required to report promptly their suspicions to the competent authorities.

***V. International co-operation***

Each country should afford another country, on the basis of a treaty, arrangement or other mechanism for mutual legal assistance or information exchange, the greatest possible measure of assistance in connection with criminal, civil enforcement, and administrative investigations, inquiries and proceedings relating to the financing of terrorism, terrorist acts and terrorist organisations.

Countries should also take all possible measures to ensure that they do not provide safe havens for individuals charged with the financing of terrorism, terrorist acts or terrorist organisations, and should have procedures in place to extradite, where possible, such individuals.

***VI. Alternative remittance***

Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal

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<sup>18</sup> Financial Action Task Force on Money Laundering, Special Recommendations on Terrorist Financing, available at [www1.oecd.org/faft/TerFinance\\_en.htm](http://www1.oecd.org/faft/TerFinance_en.htm). The Special Recommendations are to be applied in conjunction with the FAFT Forty Recommendations on money laundering.



entities that carry out this service illegally are subject to administrative, civil or criminal sanctions.

### ***VII. Wire transfers***

Countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address and account number) on funds transfers and related messages that are sent, and the information should remain with the transfer or related message through the payment chain.

Countries should take measures to ensure that financial institutions, including money remitters, conduct enhanced scrutiny of and monitor for suspicious activity funds transfers which do not contain complete originator information (name, address and account number).

### ***VIII. Non-profit organisations***

Countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Non-profit organisations are particularly vulnerable, and countries should ensure that they cannot be misused:

- i. by terrorist organisations posing as legitimate entities;
- ii. to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; and
- iii. to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.”

Thus, the FAFT proposes that States adopt reporting requirements for suspicious transactions, licensing and regulation of alternative remittance networks like hawala, information disclosure requirements for originators of money transfers and a review of laws regulating non-profit organizations, as well as international cooperation in law enforcement activities. It is notable, however, that these are *recommendations*. To address implementation by the international community, the FAFT has begun by circulating a Self-Assessment Questionnaire to member and non-member countries alike, and encouraging the completion of these Questionnaires as a means of engaging States in a dialogue about taking steps to control terror financing. Slow-acting States



risk being “named and shamed.” Thus, the three most rigorous publicly-known efforts to encourage suppression of terror financing consist of the activities of the U.N. Counter-Terrorism Committee to monitor compliance with Security Council Resolution No. 1373 through reporting requirements, the activities of the U.N. Afghanistan Sanctions Committee to follow the efforts of States to freeze assets of Al Qaeda and associates under Security Council Resolution No.1390 and the non-mandatory Special Recommendations and Questionnaire activities of the FAFT.

This implementation regime is simply too weak to result in prompt changes of attitude and conduct by non-implementing States. For example, only 43 of the United Nation’s 189 member States had on April 29, 2002 provided the Afghanistan Sanctions Committee with reports as to the Al Qaeda freeze mandated by the Security Council to be due by that date. Some of the reports that did arrive demonstrated limited willingness to invest in the effort to fulfill international mandates; Indonesia and Syria each reported no funds of Al Qaeda or associates could be found in their territories.<sup>19</sup> It is unrealistic to expect quick movement towards effective national systems to suppress terror financing in regions lacking commitment to the rule of law, adequately supervised corporate internal controls and record-keeping requirements or accountable public institutions. Impressive as the international proscriptions appear, they do not serve to restrict terror financing unless they are effectively implemented and enforced. In April 2002, the Spokesman for the Counter-Terrorism Committee’s Group of Experts, Dr. Walter Gehr, noted in an understated fashion as part of a briefing for member States that “the group of experts has noticed that a number of reports does not [sic] elaborate on how [international cooperation on administrative matters] has been or will be used to prevent the commission of terrorist acts.”<sup>20</sup>

Far too many countries lack the resources, expertise and commitment to establish an adequate supervisory framework for their commercial banking system, let alone the additional systems necessary to target suspicious money transfers and accounts. For example, the World Bank has been supporting finance sector reform in Pakistan since at least 1983, including a large Financial Sector Adjustment Loan in 1989-90, a \$216 million Financial Sector Deepening and Intermediation Project loan in 1994 and a \$21 million low-interest IDA loan last year to support upgrading an electronic payments system. World Bank support for financial sector reform has been complemented by aid from other multilateral and bilateral donors, but today the Pakistani system of financial services regulation and compliance is weak at best. Weaknesses in financial

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<sup>19</sup> DeYoung & Farah, supra n.7, at A10.



services regulation are compounded by weaknesses in law enforcement. Again, Pakistan is an instructive example, where institutional weakness is reinforced far too often by widespread corruption. In Transparency International's 2001 Corruption Perceptions Index, Pakistan tied for seventh worst in the world. In addition to inadequate capabilities in the formal financial services sector, government supervision of informal money transfer networks is theoretical at best. These public sector inadequacies magnify basic commercial problems, most particularly poor adherence to internationally accepted standards of record-keeping, accounting and other internal corporate controls.

And Pakistan is merely one illustration among many of a State in which terror financing develops roots.

None of these problems is particularly new. All have been the object of considerable attention from host governmental authorities, development institutions, NGO's and donor countries. Most of that attention has taken the form of economic and technical assistance. While the regulatory scheme for financial services may have improved in the past decade in many developing countries, institutional capabilities remain woefully inadequate to the task of suppressing terror financing. Further, until September 11 the incentives to improve rapidly were little greater than had been the case for the past several decades. In part, this situation has been the result of a laissez faire attitude on the part of the developed world. For a long time, only limited Western interests have been adversely affected by these systemic problems. As long as commercial ventures in the developing world have been the primary interests harmed by these problems, Western governments have offered little assistance. For the United States, this approach started to change when weaknesses in banking systems in Latin America and Asia began to directly affect the U.S. through the drug trade. Occasional highly publicized successes in capturing drug proceeds demonstrate the intensity of efforts to clamp down on the use of financial institutions to finance illegal drug activities. Still, the continuing severity of the illegal drug problem in the United States provides ample evidence that financial interdiction activities have not succeeded in reversing this trend.

Absent a dramatically different approach, efforts at interdicting flows of terror money could prove even less successful than efforts at interdicting flows of drug money. The sums involved in terrorist operations and terrorist capital expenditures are far smaller than the many billions of dollars spent each year as part of the illegal drug trade. It is therefore easy to predict that control

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<sup>20</sup> Id., at text below footnote 12.



of terror money will be even more elusive. Accordingly, a different approach is required – technical and economic assistance by itself will not suffice, no matter how much the non-implementing State is “named and shamed” to make reforms.

Current efforts do not involve meaningful incentives or disincentives calculated to cause money transmitters and public authorities in non-implementing States to make effective changes. Too many money remitters and financial institutions in non-implementing States lack real incentives to reform themselves, and host governments lack both resources and incentives. Equally, Western assistance has not been linked to any attention-getting disincentives applicable if efforts to reform continue to limp along at an unacceptable rate. Even fewer tools have been available to alter the behavior of the financial intermediaries themselves. Hard as it may be to identify direct costs to non-implementing States of failing to reform, it is even harder to do so with respect to financial institutions in those States lacking internal controls or responsible programs to comply with applicable law. And the effort to develop disincentives to misconduct on the part of alternate money transmission networks has barely begun.

A rigorous look at a new approach should start with the creation of significant penalties to be imposed directly on non-implementing States and their financial institutions, not with precatory reliance on non-implementing States to impose penalties on their own non-implementing institutions. As long as host States remain uncommitted to dramatic change, it is not realistic to rely on promises by those States to impose financial or regulatory penalties on their own regulated (or unregulated) enterprises. Others must therefore impose the penalties. States affected by the absence of respect for these international obligations nonetheless need to do business with states such as the United States, Canada, members of the Europe Union and Japan. For example, financial institutions from a non-implementing State could be denied the right to maintain permanent establishments and correspondent banking accounts in money centers like New York City, London, Toronto, Paris, Frankfurt, Zurich and Tokyo. Senior political appointees of the financial services regulatory authorities of non-implementing States, and their families, could even be denied visas to travel to money center jurisdictions. Other prices for failure to implement serious controls over terror money can easily be imagined, and in each case would raise the stakes for non-complying States and their ventures.

Successful creation of a system of incentives and disincentives that relies on financial services trade restrictions will require multilateral cooperation. “Our efforts cannot be successful if



prosecuted unilaterally and are ultimately doomed to failure if we cannot obtain the cooperation of other nations,” said Juan Zarate, U.S. Treasury Deputy Assistant Secretary for Terrorism and Violent Crime, in prepared testimony before a House of Representatives subcommittee.<sup>21</sup> Large as the U.S. financial markets may be, unilateral U.S. action will be ineffective if alternative financial centers operate outside the reach of U.S. controls. Indeed, the development of the offshore Eurodollar market in London can be traced to unilateral U.S. financial actions. These include U.S. freeze orders affecting Soviet business and the imposition of interest rate ceilings on bank deposits within the U.S. under old Federal Reserve Board Regulation Q. Also of moment were U.S. balance-of-payment controls imposed during the 1960’s -- such as the Interest Equalization Tax, voluntary controls on U.S. bank lending and investment abroad, and eventual compulsory controls in 1968. Those enactments by the U.S. created incentives for banks to take U.S. dollar deposits and make U.S. dollar loans in jurisdictions outside the reach of the U.S. tax and banking authorities. Accordingly, the United States must cooperate in creating this proposed enforcement system with other money centers; among them, Canada, the U.K., the other European Union States, Japan, Singapore, China (Hong Kong) and Bahrain. A critical mass of money center jurisdictions will be necessary to create real incentives for non-implementing States to mend their ways. Universal adherence to this enforcement system is not, however, necessary so long as the magnitude of penalties imposed by cooperating members of the financial coalition does in fact create real incentives to change.

The arguments against this approach need to be examined. First among them is the concern that these penalties amount to economic sanctions. Do economic sanctions against financial services in non-implementing States undermine development in the poorest of the poor by cutting the financial lifeblood of commercial activities? That argument, however, overstates the relative cost to commercial enterprises of the proposed steps. In non-implementing States where local commercial ventures are permitted to maintain direct banking relations with international banks, those relations will continue and they will be directly subject to the supervisory framework of the USA Patriot Act and similar national enactments by the members of the financial coalition. Where the non-implementing State denies its citizens the ability to freely choose their banks, but instead mandates the use of domestic financial institutions, those domestic financial institutions will still wish to maintain correspondent accounts in money center jurisdictions in implementing States. Financial transactions in non-complying states will thus be able to continue, but in an awkward two-step manner that will be a constant reminder of the reputation and transactional

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<sup>21</sup> Zarate Testimony, supra n.5.



costs of failing to implement the Security Council Resolutions and the Convention. Thus, the out-of-pocket costs of compliance for local commercial activity would be limited compared to the adverse impact of the administrative burdens and stigma associated with being denied direct access to financial centers. The adverse impact on legitimate commercial enterprises in non-implementing States could lead to the growth of a local interest group in favor of reform.

A second potential objection is that the United States may lose some commercial relationships if penalties are imposed on its commercial partners, seriously and adversely affecting other long-term American interests. Involving a number of money center jurisdictions in a multilateral system of penalties can mitigate this impact, as would the availability of meaningful assistance for non-implementing States to make the necessary changes.

A skeptic may argue, as a third objection, that sanctions by themselves cannot create reform in a State without resources and training to achieve the necessary reforms. A program to impose serious penalties by the financial coalition cannot replace the need for technical and economic assistance; it can only create an environment in which interests are aligned. Accordingly, maintenance of assistance flows for the reforms necessary to implement international anti-terror financing obligations remains central to a successful result. Provision of assistance is thus in the obvious interests of the United States and other countries threatened by terror. The Justice Department has attorneys from the Asset Forfeiture and Money Laundering Section participating in State Department-led interagency training and technical assistance assessment teams overseas. The Treasury Department has been sending “jump teams” of technicians, legal experts and senior officials to interested countries to help install new computer systems and write new laws. The FAFT maintains a database of technical assistance programs available from around the world and is prepared to work with both member and non-member countries to utilize those programs. American efforts are complemented by efforts by members of the European Union and other States. Nevertheless, funds to hire technical assistance is equally important.. Without additional resources, many countries simply cannot deploy the people and systems necessary to do a diligent job of tracking illicit money flows. Carried to an extreme, American resistance to foreign aid could undermine the ability to suppress terror financing.

It is easy to write an essay proposing a program of serious penalties for non-implementation. It is far harder to actually develop and implement such a program. In particular, acceptable benchmarks must be developed to measure progress. On-the-ground access to the regulators and



regulated institutions in non-implementing States will be essential to apply those benchmarks. Audits and examinations are crucial supervisory tools. These are real problems of implementation, but both the U.S. and the European Union have existing programs to determine compliance with financial services regulatory requirements. A starting point thus exists. The mountain of implementation is not so high that it is useless to even try to climb it.

There is no legal impediment to this enforcement regime from trade-related obligations. A U.N.-imposed sanctions regime enforcing controls on terror financing would supercede any other commercial or international obligations concerning the right of investors to establish businesses and similar trade rights. States are required to comply with the mandate of Security Council Resolutions Nos. 1373, 1377 and 1390 under Articles 25 and 48(1) of the U.N. Charter, thus providing affirmative international law support for a strong system to enforce those obligations. By operation of Article 103, the U.N. Charter takes precedence over any other international legal obligation (with the possible exception of *jus cogens* norms). Thus a strong system to thwart participation in terror financing and to gain compliance through state regulation does not violate any other international legal commitments of the member states.

In addition, the Annex on Financial Services to the General Agreement on Trade in Services (“GATS”) permits financial services regulators to undertake prudential regulation; WTO Members are not prevented “from taking measures for prudential reasons, including for the protection of investors, depositors, policyholders or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system.”<sup>22</sup> The right of WTO Members to protect their essential security interests is also recognized by Article XIV bis, clause 1 of the GATS. Moreover, subclause 1(c) of Article XIV bis explicitly recognizes that nothing in the GATS is to be construed “to prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.” Accordingly, the mandatory obligations of a State under Chapter VII of the U.N. Charter are given priority over any contrary provision of the GATS, even within the terms of the GATS regime.

The International Monetary Fund, too, permits States to maintain national security exchange restrictions (including restrictions on opening and maintaining accounts). Article VIII, Sec. 2(a) of the Articles of Agreement of the International Monetary Fund prohibits exchange restrictions



on current payments and transfers, absent approval of the Fund. The U.S. blocking orders against China and North Korea required the Fund to consider how to address national and international security restrictions. In a decision taken in 1952,<sup>23</sup> the IMF Board decided that, when a member proposed to impose exchange restrictions on current transactions on security grounds, it should notify the Managing Director of the IMF. Unless the member in question is notified otherwise, the member State may assume that the Fund has no objection to the imposition of the restrictions. Similarly, U.S. and other bilateral investment treaties customarily reserve the right of a party to take measures that it considers necessary for the fulfillment of its international obligations with respect to maintenance or restoration of international peace or security, as well as those measures it regards as necessary for the protection of its own essential security interests. Accordingly, it is clear that trade restrictions on non-implementing States may be imposed by a financial coalition in a manner consistent with existing obligations under international law.

In summary, the United States must lead a multilateral financial coalition to suppress terror financing. Current efforts focus on encouraging voluntary international cooperation, but non-implementing States are unlikely to make the necessary changes without some greater pressure. The incentives can, and should, include the risk of meaningful penalties for non-implementing States and their financial institutions unless those States demonstrate prompt enforcement of their obligations under Security Council Resolutions and the International Convention for the Suppression of Financing of Terrorism. Financial and technical assistance will be crucial to enable non-implementing States to satisfy U.S. demands to meet these requirements.

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<sup>22</sup> Article 2(a), Annex on Financial Services, General Agreement on Trade in Services.



## APPENDIX

Excerpt from pages 9-11 of Statement for the Record of

Dennis M. Lormel,

Chief, Financial Crimes Section,

Federal Bureau of Investigation

Before the Subcommittee on Oversight and Investigation, U.S. House of Representatives  
Committee on Financial Services

February 12, 2002

### **“ACCOUNT PROFILE [OF SEPTEMBER 11 TERRORIST HIJACKERS]**

- Accounts were opened with cash/cash equivalents in the average amount of \$3,000 to \$5,000.
- Identification used to open the accounts were visas issued through Saudi Arabia or the U.A.E.
- Accounts were opened within 30 days after entry into the U.S.
- All accounts were normal checking accounts with debit cards.
- None of the hijackers had a social security number.
- They tended to open their accounts in groups of three or four individuals.

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<sup>23</sup> Decision No. 144-(52/51), August 14, 1952.



- Some of the accounts were joint accounts with other hijackers.
- Addresses used usually were not permanent (i.e. mail boxes, etc.) and changed frequently.
- Hijackers would often use the same address/telephone numbers on the accounts. No savings accounts or safe deposit boxes were opened.
- Hijackers would open their accounts at branches of large well known banks.
- The majority of hijackers (12) opened accounts at the same bank.

## **TRANSACTION PROFILE**

- Some accounts would directly receive/send wire transfers of small amounts to foreign countries  
- UAE, Saudi Arabia, Germany.
- Hijackers would make numerous attempts of cash withdrawals which often would exceed the limit of the debit card.
- High percentage of withdrawals were from debit cards vs. low percentage of checks written.
- Numerous balance inquiries were made.
- Hijackers would often travel domestically.
- There was a tendency to use Western Union to wire money.
- One deposit would be made and then the money would trickle out a little at a time.
- Account transactions did not reflect normal living expenses for rent, utilities, auto payments, insurance, etc.
- There was no normal consistency with timing of deposits/disbursements.



- Funding for normal day to day expenditures was not evident from transactions.
- Overall transactions are below reporting requirements.
- Funding of the accounts dominated by cash and overseas wire transfers.
- ATM transactions occur where more than one hijacker present (uninterrupted series of transactions involving several hijackers at the same ATM).
- Use of debit cards by hijackers who did not own affected accounts.

## **INTERNATIONAL ACTIVITY**

- Three of the hijackers supplemented their financing by opening foreign checking accounts and credit card accounts at banks located in the UAE.
- While in the U.S., two of the hijackers had deposits made on their behalf by unknown individuals.
- Hijackers on all four flights purchased traveler's checks overseas and brought them to the U.S. These traveler's checks were partially deposited into their U.S. checking accounts.
- Three of the hijackers (pilots/leaders) continued to maintain bank accounts in Germany after moving to the U.S.
- Two of the hijackers (pilots/leaders) had credit cards issued by German banks and maintained those after moving to the U.S.
- It is suspected that other unknown foreign accounts exist that were opened by the hijackers to further supplement the financing of the September 11, 2001 attacks.



- One of the hijackers (pilot/leader) received substantial funding through wire transfers into his German bank account in 1998 and 1999 from one individual.
- In 1999, this same hijacker opened an account in the UAE, giving power of attorney over the account to this same individual who had been wiring money to his German account.
- More than \$100,000 was wired from the UAE account of the hijacker to the German account of the hijacker in a 15-month period.”





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